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SUBJECT: LOOKING FOR ALTERNATIVES TO AN ICESAVE REFERENDUM

REF: REYKJAVIK 9

Classified By: CDA SAM WATSON FOR REASONS 1.4 (B) AND (D)

1. (C) Summary. CDA met with Ministry of Foreign Affairs Permanent Secretary Einar Gunnarsson and Political Advisor Kristjan Guy Burgess January 12 to discuss Icesave. After presenting a gloomy picture of Iceland's future, the two officials asked for U.S. support. They said that public comments of support from the U.S. or assistance in getting the issue on the IMF agenda would be very much appreciated. They further said that they did not want to see the matter go to a national referendum and that they were exploring other options for resolving the issue. The British Ambassador told CDA separately that he, as well as the Ministry of Finance, were also looking at options that would forestall a referendum. End Summary.

2. (C) CDA met with Permanent Secretary Einar Gunnarsson and Political Advisor Kristjan Guy Burgess at the Icelandic Ministry of Foreign Affairs on January 12 for a two hour marathon meeting to discuss Icesave. The Icelandic officials painted a very gloomy picture for Iceland's future. They suggested that the most likely outcome for the country was that the Icesave issue would fail in a national referendum. Should that occur, they suggested, Iceland would be back to square one with the British and the Dutch. The country, however, would be much worse off because it would have lost international credibility and access to financial markets. Gunnarsson suggested that the Icesave issue, if it continues along its present course, would cause Iceland to default in 2011 when a number of loans become due and could set Iceland back 30 years.

3. (C) The two government officials stressed that Iceland needs international support. CDA reiterated that the United States was neutral on this bilateral issue and hoped for a speedy resolution. Moreover, the U.S. had supported Iceland's position at the last IMF Review and expected to do so again depending on the circumstances. Gunnarsson and Burgess responded that they understood the United States' stated position of neutrality on the issue; however, they expressed the view that it was impossible to remain neutral regarding the Icesave matter. Iceland, they said, was being bullied by two much larger powers and a position of neutrality was tantamount to watching the bullying take place. They suggested that a public statement from the U.S. in support of Iceland would be very helpful. They also felt that U.S. intervention in the IMF could be of assistance, specifically if it was targeted at getting Iceland's review placed on the IMF agenda. Gunnarsson acknowledged that U.S. support during the review was appreciated but, realistically, the issue would never make it on the agenda unless external pressure was applied on the IMF.

14. (C) Gunnarsson and Burgess were extremely pessimistic regarding the national referendum and said that the Government of Iceland was exploring other options to resolve the Icesave situation. They hinted that renegotiation might be a viable alternative and referenced recent meetings between the government and the opposition at which this option was discussed. Everyone could potentially save face, they suggested, if a new repayment agreement was reached with the British and Dutch that could possibly include a lower interest rate for the loan. This solution, they felt, would be palatable to the Icelandic people and potentially to the opposition as well. They did not know, however, whether the British and Dutch would agree to another round of negotiations. They also acknowledged that any new agreement would have to be approved in parliament and, of course, signed by the president.

15. (C) On January 13, CDA also discussed the situation with British Ambassador Ian Whiting who said that Britain might consider options that would forestall a national referendum on the Icesave issue. The Ambassador said, however, that the British Government was receiving mixed messages from the Icelanders who, one week ago, seemed content to move forward with a referendum (as the Prime Minister had conveyed to her UK counterpart) but now appeared to be looking at other options. For example, the Ministry of Finance was already looking at ways to improve the agreement but not undermine the obligation or certainty of payment. He outlined for CDA a potential solution that he was exploring that would involve Norway loaning Iceland the money to cover the Icesave debt. This idea, he felt, had merit because it would create a situation in which the Icelandic Government was dealing with

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a country that it perceived to be sympathetic to its situation, a fact that could remove some of the animosity from the renegotiations. Negotiating a good loan repayment agreement with Norway, said Whiting, would allow both sides to claim victory. The British and Dutch would receive their money and Iceland would be able to repay its debts under more favorable terms. He was going to discuss the idea with the Norwegian Ambassador that same day.

16. (C) On January 13, CDA also met Iceland's Ambassador to the United States Hjalmar Hannesson who was in Iceland. The Ambassador described the potential constitutional crisis that would likely ensue should the referendum go forward and fail, in essence a vote of no confidence. In that case, the constitutionally apolitical Head of State would have brought down the elected government, a possibility that several former politicians in both parties had long ago agreed should not happen. Despite his and his family's long association with the Progressive Party, Hannesson said that this was not the time for elections or a change of government. He added that he did not sense a willingness on the part of the opposition to take control of the government. Noting that the President, whom he has known for years, is considered "unpredictable," he hoped that a solution palatable to all sides in Iceland could provide a way out.

17. (C) Comment: It is quickly becoming clear that very few of the involved parties are comfortable with the Icesave issue being put to a vote in a national referendum. Both the ruling coalition and the opposition appear to understand that they must present a united front for there to be any possibility of discussing alternative solutions with the British and Dutch. At present, such cooperation remains elusive; however, a number of closed door meetings between the opposition and government will take place in the coming days to explore the full range of potential solutions and, hopefully, to forge consensus. All of this, however, remains in flux.

WATSON